



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

August 23, 2006

Mr. Raynor Tsuneyoshi, Director
Department of Boating and Waterways
2000 Evergreen Street, Suite 100
Sacramento, CA 95815

Dear Mr. Tsuneyoshi:

Final Report: Department of Boating and Waterways—Internal Control Review

Enclosed is our final internal control report on the Department of Boating and Waterways (Department) as of December 8, 2005. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review in accordance with the Financial Integrity and State Managers' Accountability Act of 1983.

The Department's response and Finance's evaluation of the response is included in the report.

The final report will be placed on the Finance website in accordance with Finance's policy of increased transparency. We appreciate the assistance and cooperation of the staff and management during our review. If you have any questions, please contact Kimberly A. Tarvin, Manager, or John R. Rogers, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Debra DeVerter, Chief of Administrative Services, Department of Boating and Waterways

AN INTERNAL CONTROL REVIEW

Department of Boating and Waterways

Prepared By:
Office of State Audits and Evaluations
Department of Finance

TABLE OF CONTENTS

Preface	iii
Executive Summary	v
Auditor's Report	1
Findings and Recommendations	3
Conclusion	12
Department Response	13
Evaluation of Response	18

The Department of Boating and Waterways' (Department) mission is to provide safe and convenient public access to California's waterways and leadership in promoting the public's right to safe, enjoyable, and environmentally sound recreational boating. The Department accomplishes this goal by administering the boating facilities, boating operations, and the beach erosion control programs.

The boating facilities program expands and improves public boater access by granting funds to cities, counties, and other governmental agencies for the design and construction of boat launching facilities, floating restrooms, and vessel sewage pump-outs. The program also provides loans to cities, counties, and districts for the planning, design, and construction of small craft harbors; and provides loans to businesses for the development of recreational marinas. In addition, the program plans, designs, and constructs boating facilities on state-owned or controlled properties, and provides aquatic weed control in the Sacramento-San Joaquin Delta, its tributaries, and the Suisun Marsh.

The boating operations program ensures safe and enjoyable boating on California waters for the public by promoting boating safety and education, assisting local boating law enforcement agencies, ensuring uniformity in boating regulations, and licensing for-hire boat operators and yacht and ship brokers. In addition, the program gathers statistical information on boating accidents to monitor accident trends and problem areas, and researches and documents the causes of accidents.

The beach erosion control program helps mitigate coastal erosion through beach enhancement and restoration efforts. Regional beach erosion restoration projects are constructed by the United States Army Corps of Engineers in cooperation with state and local agencies. Localized beach restoration is typically constructed by local agencies with state cooperation.

The Department is mainly funded through the Harbors and Watercraft Revolving Fund, a public enterprise fund with additional funding sources coming from reimbursements, the Abandoned Watercraft Abatement Fund, and the Federal Trust Fund.

State managers are required to establish and maintain internal controls over the programs they administer. These controls are defined as a process to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. This definition includes five interrelated components:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.

- *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of this internal control review is to assist the Department in complying with the Financial Integrity and State Managers' Accountability Act of 1983. Specifically, the review assists the Department in determining whether: (1) assets are safeguarded from unauthorized use or disposition, (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements, and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, and certain other state laws and regulations, as well as the Department's policies and procedures.

This report is intended for the information and use of the Department and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Mary C. Kelly, CPA
Manager

John R. Rogers, CPA
Supervisor

Michael West, CPA
Zach Stacy
Vary Kuevor
Kylie Le
Toni Bourez

EXECUTIVE SUMMARY

During the review of the Department of Boating and Waterways' (Department) internal control as of December 8, 2005, the Department of Finance, Office of State Audits and Evaluations' (Finance) identified several areas where controls were in place and working as intended and also identified areas where controls could be improved. If uncorrected, these weaknesses could expose the Department to increased risk of errors, irregularities, and material misstatements in the financial statements. Finance staff met with Department management and staff on December 15, 2005 and discussed the following areas:

Administrative Controls: The review identified various administrative or management controls that could be improved to help ensure operational efficiency. Specifically, separation of duties over various accounting functions and controls over the reconciliation process of key accounting records and accounts were inadequate.

Information Technology: The Department's information technology controls appear adequate to ensure the overall reliability and integrity of data. The Department has an adequate disaster recovery plan in place.

Budget: The Department's controls over its budget functions appear adequate to ensure the reliability and integrity of data. However, major budget revisions were not posted to the allotment expenditure ledger in a timely manner.

Cash Receipts: Based on the review, the Department's controls over cash receipts appear adequate to ensure assets were properly safeguarded. Proper separation of duties exists, warrants were restrictively endorsed upon receipt, deposits were made in tact, and checks received were timely recorded on a collection report. However, no record was kept of when the safe combination was last changed or which staff have access or knowledge of the combination. The Department did not remit cash receipts to the State Treasurer's Office in a timely manner, nor prepared pre-listings and transfer receipts for checks not made payable to the Department.

Receivables: The Department's controls over receivables need improvement to ensure amounts due to the Department are appropriately recorded and collected. The accounting unit was notified timely of when services were rendered and the amounts due, and procedures exist for timely and accurate billing of receivables. However, segregation of duties were inadequate and established procedures did not exist to adequately address delinquent receivable collections and write-offs.

Purchasing: The Department's controls over purchasing need improvement. Stock received reports were not prepared to ensure goods were received prior to approving payment. Additionally, the separation of duties related to various purchasing functions was inadequate.

Cash Disbursements: The Department's controls over cash disbursements appear adequate to ensure uncashed/unclaimed checks and blank check stock were appropriately safeguarded, checks were adequately reviewed and authorized prior to distribution, and checks were appropriately voided. However, segregation of duties over the cash disbursement process was inadequate (see Revolving Fund below), and bank reconciliations were not performed timely or signed and dated by the preparer and reviewer. Further, the review identified \$45,569 in uncleared reconciling items that were over one year old. Also, obsolete checks were not destroyed.

Revolving Fund: The Department's revolving fund controls appear adequate. Based on the review, the revolving fund was used appropriately and salary and travel advances were resolved timely. However, the check preparer also distributed the checks, and the reconciliations were not signed and dated by the preparer and reviewer. In addition, the Department did not utilize a cash book to help track its revolving fund transactions, and a lack of accountability exists for the petty cash account.

Personnel/Payroll: The Department's controls over the personnel and payroll functions were sufficient to ensure the reliability and integrity of data. The Department maintains adequate segregation of duties, leave records maintained were in compliance with state regulations, and adequate procedures exist for undeliverable warrants. However, the separated employee's lump sum calculations were not independently reviewed by another staff member.

Contracts: The Department's contracting controls appear adequate. Based on the review, the separation of duties was adequate, contracts were supported by appropriate documentation, and contract administration and monitoring were adequate to ensure achievement of contracting objectives.

Fixed Assets: The Department's fixed asset controls were not sufficient to ensure the appropriate safeguarding of state assets. Specifically, the Department does not perform monthly reconciliations of the equipment general ledger with the property ledger, property ledgers were incomplete, physical inventory counts could not be verified, assets were not depreciated, and the separation of duties related to the fixed assets activities was inadequate.

Financial Reporting: The Department's financial reporting controls appear adequate. We observed that required financial statements were prepared, certified, and timely submitted to the State Controller's Office. However, required federal reports were not always submitted to federal agencies on time.

For further details related to the issues summarized above, see the Findings and Recommendations section of this report.

This report is intended to assist Department management in focusing attention on areas risk, and in strengthening internal control, and improving operations.



AUDITOR'S REPORT

Mr. Raynor Tsuneyoshi, Director
Department of Boating and Waterways
2000 Evergreen Street, Suite 100
Sacramento, CA 95815

The Department of Finance, Office of State Audits and Evaluations (Finance), reviewed the Department of Boating and Waterways' (Department) internal control in effect as of December 8, 2005, for conformity with Government Code, Section 13400, et seq. Our review included obtaining an understanding of the Department's internal control through observations and interviews, identifying risks, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we considered necessary under the circumstances.

The Department management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code, Section 13400, et seq., includes documenting internal control, communicating control requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling its responsibilities, management is required to assess the expected benefits and costs of its control procedures.

The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the state Administrative Manual, and certain other State laws and regulations, as well as the Department's policies and procedures.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Department's internal control as of December 8, 2005, we identified certain matters involving the internal control and its operation that are considered reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the

assertions of management in the financial statements. These reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended solely for the information and use of Department management and is not intended to be and should not be used by anyone other than the specified party. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations
(916) 322-2985

December 8, 2005

FINDINGS AND RECOMMENDATIONS

Based on the Department of Finance, Office of State Audits and Evaluations' (Finance), review of the Department of Boating and Waterways' (Department) accounting and administrative controls in effect as of December 8, 2005, we identified a number of controls that were functioning as intended. However, we also identified areas where controls are not in place, and where corrective action is necessary as described below.

Administrative Controls

Administrative or management controls relate to operational efficiency, adherence to managerial policies, and management's authorization of transactions. Department management is responsible for overseeing activities conducted within their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls over operations. The following weaknesses were identified:

FINDING 1 Inadequate Separation of Duties

Condition: The Department has not maintained adequate separation of duties over various accounting functions, thereby increasing the risk of errors and misappropriation of state assets.

Purchasing/Fixed Assets—The Business Services Assistant prepares purchase orders and contracts, receives goods, attaches the property tags to the equipment, maintains custody of the unassigned equipment, compares receiving documents with purchase orders, compares invoices to receiving documents, disposes of equipment, participates in the physical inventory count process, and reconciles the inventory counts to the perpetual inventory. Additionally, as noted in Finding 2, no one reconciles the perpetual inventory to the general ledger inventory balance, further increasing the risk that misappropriation of assets could occur without detection.

Cash Disbursements—The Accountant Trainee that prepares revolving fund checks also disburses those checks and reconciles the revolving fund.

Receivables—The Accountant I originates billings, prepares invoices, posts receivables to the general ledger, reconciles the receivables to the general ledger, and performs collection of the aged receivables.

Criteria: State Administrative Manual (SAM) Section 20050 states that managers, by reason of their appointments, are accountable for activities carried out in their agencies. This responsibility includes the establishment and maintenance of effective accounting and administrative controls over

assets, liabilities, revenues, and expenditures. A good system of internal control includes a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets and providing reliable financial information.

SAM Section 8041.2 states that checks will not be routed through the person who prepared or approved the related claim or invoice, nor will it be returned for mailing or distribution to the person who prepared it.

SAM Section 8080.1 provides the appropriate level of separation of duties over accounting systems, and details conflicting duties.

Recommendation: Segregate duties to ensure adequate safeguarding of state assets and reliable financial reporting.

FINDING 2 Inadequate Controls over the Reconciliation Process

Condition: Reconciliations that attest to the accuracy of accounting records are either not performed on a regular basis or are performed incorrectly, increasing the risk that misstatements in the accounting records due to errors or fraud will not be prevented or detected in a timely manner.

SCO Reconciliation—SCO reconciliations are not reviewed by someone other than the preparer, nor are they signed and dated by the preparer and reviewer.

Bank Reconciliation—As of November 2005, the last completed bank reconciliation was for April 2005. In addition, the Department had \$45,569 in uncleared reconciling items that were over one year old and date as far back as April 1999. Also, two of the three bank reconciliations reviewed were not properly signed or dated by the reviewer or preparer.

Revolving Fund—None of the three revolving fund reconciliations reviewed were properly signed or dated by the reviewer or the preparer. In addition, the cash book balance stated in the reconciliation is based on a calculation since the Department does not maintain a revolving fund cash book.

Accounts Receivables—The Department states that a reconciliation between the payment log and the California Accounting and Reporting System is performed monthly. However, this reconciliation is not retained. Therefore, the accounts receivables reconciliations could not be evaluated to determine whether the reconciliations were adequate, timely, accurate, or reviewed by a second individual.

Fixed Assets (equipment)—The Department does not currently reconcile the property ledger to the general ledger. The general ledger account for equipment has not been updated since 1998. As a result, there is a difference of \$164,343 between the property ledger and the general ledger for items over \$5,000 as of December 2005.

Criteria: SAM Section 7907 states all reconciliations will be prepared monthly within 30 days of the preceding month.

SAM Section 7908 states that all reconciliations will show the preparer and reviewer's name along with the date prepared and the date reviewed.

SAM Section 7901 states that the accuracy of an agency's accounting records may be proved partially by making certain reconciliations and verifications. Reconciliations must be completed between the agency accounts and the accounts maintained by the SCO to disclose errors as they occur. Corrections to errors should be made before financial reports are prepared to partially ensure the accuracy of an agency's financial reports. All reconciliations will be prepared monthly within 30 days of the preceding month.

SAM 7800 states the form and content of subsidiary records may vary among agencies except as specifically described in other chapters. These records will be reconciled to the general ledger monthly.

SAM 7821 requires that the agency reconciles the property ledger to the general ledger control account.

Recommendation: To ensure the accuracy of the accounting records, the Department should ensure that:

- All reconciliations are completed in a timely manner.
- Reconciled differences are promptly resolved.
- The revolving cash account book is maintained and reconciled to the revolving fund advance.
- Reconciliation schedules are signed and dated by the preparer and reviewer.

Budget

Effective internal control over the budget process is necessary to ensure that controls are adequate for the proper development, approval, and recording of the budget. The following weakness was identified:

FINDING 3 Untimely Postings of Major Revisions to the Allotment Expenditure Ledger

Condition: Budget Revisions are not updated timely in the Allotment Expenditure Ledgers. Specifically, in fiscal year 2004-05, Budget Revision Number Two and Budget Revision Number Three were approved by the Department of Finance's Budget Unit in November 2004, but not posted to the Allotment Expenditure Ledger until June 2005. If budget revisions are not posted in a timely manner, program managers and budget staff can not effectively manage or monitor program expenditures.

Criteria: SAM Sections 6533 and 8322 require the agency to record the revision of allotments reported on the Standard 26 Budget Revision Form to the allotment expenditure ledger upon submission, subject to reversal or adjustment if not approved.

Recommendation: Record all major budget revisions in the allotment expenditure ledgers in a timely manner.

Cash Receipts

Effective internal control over the cash receipts process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and timely detect any errors or irregularities. The following weaknesses were identified:

FINDING 4 Failure to Prepare Prelistings or Transfer Receipts

Condition: The Department does not prepare a prelisting for checks received that are not made payable to the Department. Additionally, transfer receipts are not utilized when these checks are transferred between employees. As a result, the Department is at increased risk of loss or theft of checks received.

Criteria: SAM Section 8021.1 states that all incoming mail receipts consisting of cash or negotiable instruments not made payable to the state agency will be prelisted by the person opening the mail to localize accountability of these assets.

SAM Section 8021 states that a separate series of transfer receipts will be used to localize accountability for cash or negotiable instruments to a specific employee from the time of its receipt to its deposit.

Recommendation: Ensure prelistings are prepared and transfer receipts utilized when cash or negotiable instruments not made payable to the state agency are received by the Department.

FINDING 5 Untimely Remittance to the State Treasurer

Condition: Cash receipts collected for July, August, and September 2005 were remitted to the State Treasurer 37, 7, and 15 days late, respectively. These untimely remittances resulted in approximately \$23,000 in lost interest income to the state.

Criteria: SAM Section 8091 states that regardless of the amount, agencies will remit to the State Treasury all moneys determined to be revenue, reimbursements, and operating revenue within 30 days following the date collected, unless more frequent remittances are required by law, regulation, or circumstance.

Recommendation: Remit cash receipts to the State Treasurer within 30 days following the date collected.

FINDING 6 Inadequate Controls over Safe Access

- Condition: The Department does not maintain a record to indicate which staff has access to the safe, or when the combination was last changed. An increased risk of theft or misappropriation of assets exists when controls over safe access are compromised.
- Criteria: SAM Section 8024 states that a record will be kept showing the date the combination was last changed and the names of persons knowing the present combination.
- Recommendation: Maintain an updated listing of employees who have access to the safe and notate when combination changes occur.

Account Receivables

Effective internal control over the receivables process is necessary to ensure that all amounts due are promptly collected and properly recorded. The following weakness was identified:

FINDING 7 Inadequate Collection Efforts on Delinquent Receivables

- Condition: The Department's collection efforts on delinquent receivables are inadequate. Specifically, the Department does not have a formalized written process in place to collect and write-off delinquent receivables. As a result, the amount of uncollectible receivables is likely to be increased and could result in the receivables account being overstated.
- Criteria: SAM Section 8776.6 requires that each department develop collection procedures that will assure prompt follow-up on receivables.
- Recommendation: Develop procedures to collect delinquent receivables and write-off uncollectible accounts.

Purchasing

Effective internal control over purchasing is necessary to ensure that proper payments are made and goods received agree with the purchase orders. The following weakness was identified:

FINDING 8 Stock Received Reports Are Not Completed to Record Receipt of Goods

- Condition: The Department does not prepare stock received reports to record receipt of goods. Therefore, a risk exists that invoices could be paid for goods not received or goods not received in working condition.
- Criteria: SAM Section 8422.20 states that agencies will prepare stock received reports or use an approved purchase order document to record receipt of goods.

Recommendation: Prepare stock received reports upon receipt of goods to ensure that all goods have been received in good condition prior to approving payment.

Cash Disbursements

Effective internal control over the cash disbursement process is necessary to ensure that controls are adequate to safeguard cash. The following weakness was identified:

FINDING 9 Failure to Destroy Obsolete Checks

Condition: The Department still retains obsolete check stock in its safe. Not destroying these obsolete checks increases the risk of fraud.

Criteria: SAM Section 1750 requires departments to dispose of unused blank accountable forms (i.e. checks, pre-numbered cash receipts). The destruction of these documents should be witnessed by the Department's internal auditing unit, or an agency employee who is not directly responsible for handling accounting documents.

Recommendation: Properly dispose of obsolete check stock.

Revolving Fund

The Department's revolving fund is intended for the payment of travel, salary, and expense advances, or where immediate expense payment is otherwise necessary. The following weaknesses were identified:

FINDING 10 Lack of a Revolving Fund Cash Book

Condition: The Department does not maintain a revolving fund cash book. Therefore, the Department cannot ensure that it has accounted for all revolving fund transactions.

Criteria: SAM Section 8190 requires each agency to maintain a cash book and receivables ledger, which at all times should equal the revolving fund advance.

Recommendation: Implement procedures to ensure that a revolving fund cash book is maintained and reconciled to the revolving fund advance on a regular basis.

FINDING 11 Lack of Petty Cash Custodianship and Records

Condition: The Department has not appointed a custodian over the petty cash account. In addition, there were no expenditure records or ledgers to substantiate the petty cash account. This increases the risk that petty cash funds could be misappropriated without detection.

Criteria: SAM Section 8111.2 requires that a staff person be given custodianship of the petty cash account to monitor and keep track of the account on a daily basis. Prudent business practices expect that expenditure records will be utilized and maintained to fully substantiate petty cash transactions and account balances.

Recommendation: To ensure the integrity of the petty cash fund is maintained, the Department should implement the following:

- Assign a custodian to maintain and account for the Department's petty cash account.
- Implement record keeping procedures to account for all petty cash activities.

Personnel/Payroll

Effective internal control over the personnel and payroll functions is required to ensure that Department staff are properly appointed, have not separated with outstanding advances or in possession of Department assets, and payroll information is processed accurately and timely. The following weakness was identified:

FINDING 12 Lack of Independent Review of Separated Employee Payments

Condition: The calculations supporting lump-sum payments for separated employees are not independently reviewed by another staff member, which increases the risk of errors in separated employee payments.

Criteria: An effective system of internal control includes independent reviews to ensure the accuracy and propriety of lump-sum payments for separated employees.

Recommendations: Establish procedures that lump-sum payment calculations for separated employees are independently reviewed by another staff member.

Fixed Assets

Effective internal control safeguards property, plant, and equipment from unauthorized acquisition, use, or disposition, and provides accurate reporting of fixed assets. The following weaknesses were identified:

FINDING 13 Incomplete Property Ledger

Condition: The property ledger does not specify which fund the item belongs to or if applicable, the depreciation method. Additionally, several items in the property ledger were missing the acquisition cost and date purchased. Further, three of eight equipment items in the property ledger that were reviewed included equipment that had already been disposed. As a result, the current property ledger does not identify fund ownership, depreciated value, or currently owned items of equipment, which increases the difficulty of reconciling the property ledger to the general ledger and providing reliable financial reports.

Criteria: SAM Section 8631 states that purchases of fixed assets should be recorded at cost in the accounting records. Cost is the purchase price plus all incidental costs incurred to put the asset into place and ready for its intended use.

SAM Section 8650 states that departments will record the following information when property is acquired:

- Date acquired
- Property description
- Property identification number
- Cost or other basis of valuation
- Owner fund
- Rate of depreciation (or depreciation schedule), if applicable

SAM Section 8643 states that when property is lost, stolen, or destroyed, departments will prepare a Property Survey Report form, STD. 152. The department will adjust its property accounting records and retain the Property Survey Report as documentation.

Recommendations: To ensure the property ledger is reliable, the Department should perform the following:

- Update the property ledger to include the funding source and if applicable, the depreciation method.
- Research the acquisition cost and purchase dates for all items.
- Update the property ledger to record the proper acquisition costs and purchase dates, and ensure disposed equipment is removed from the ledger.

FINDING 14 Inadequate Inventory Procedures

Condition: Inadequate procedures exist for physical inventory of state equipment. Specifically, a record is not kept of when the last physical inventory was conducted, and employees conducting physical inventory do not sign or date inventory sheets to certify the physical count.

Criteria: SAM 8652 requires that departments make a physical count of all property and reconcile the count with accounting records at least every three years. Worksheets should be used to take inventory and be retained for audit showing the date of inventory and the name of the employee who performed the verification.

Recommendation: To ensure that inventory procedures are adequate, the Department should perform the following:

- Retain all inventory counts as required.

- Ensure that inventory count sheets are signed and dated by the employee who verified the location and existence of the state equipment.

FINDING 15 Depreciation of Fixed Assets Not Performed

Condition: The Department does not depreciate its fixed assets in the Harbors and Watercraft Fund; an enterprise fund. If the fixed assets are not appropriately depreciated, the fixed assets account will be overstated.

Criteria: SAM Section 8616 requires departments to depreciate the fixed assets for those proprietary funds which conduct enterprise or internal service fund operations.

Recommendation: Establish procedures to ensure fixed assets are depreciated in accordance with SAM and Generally Accepted Accounting Principles.

Financial Reporting

Effective internal control over financial reporting is required to ensure that both state and federal financial reports are prepared promptly, accurately, and timely. The following weakness was identified:

FINDING 16 Untimely Submission of Federal Reports

Condition: Financial Status Reports and Performance Reports were not submitted in the timeframes imposed by the federal agencies. Although only one to two months late, we noted that reports for the United States Fish and Wildlife Clean Vessel Grant and the US Coast Guard Grant were submitted late on a consistent basis. When reports are submitted untimely to the federal agency, the risk exists that the federal funding may be disallowed or discontinued by the federal agency.

Criteria: Grant contract award documents specify the type of reports to provide and the required time frame to submit them to the federal agency.

Recommendation: Establish procedures to ensure required federal reports are submitted on time to the appropriate federal agency.

CONCLUSION

The Department of Finance, Office of State Audits and Evaluations' (Finance), review of the Department's internal control presents opportunities for Department management to correct identified weaknesses and improve the operations. We believe internal control would be strengthened and the Department would operate more effectively and efficiently if management implements the recommendations. Internal control weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected, and could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The findings in this report are based on fieldwork performed between September 19, 2005 and December 8, 2005. We presented these findings to the Department at the completion of each cycle and at the exit conference held on December 15, 2005.

DEPARTMENT RESPONSE

DEPARTMENT OF BOATING AND WATERWAYS

2000 EVERGREEN STREET, SUITE 100
SACRAMENTO, CA 95815-3888
Tele: (916) 263-4326
Fax: (916) 263-0648
www.dbw.ca.gov



August 3, 2006

Ms. Diana L. Ducay, Chief
Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Ms. Ducay:

Thank you for the opportunity to respond to the Draft Internal Control Review Audit Report on the Department of Boating and Waterways' Internal Control Review. Attached are the responses and comments to the specific findings.

We appreciate the efforts of the audit team in helping us to strengthen our internal controls and processes.

If you have any questions, please contact Debra DeVerter, Chief of Administrative Services at 916.263.0842.

Sincerely,

Original signed by:

Raynor Tsuneyoshi
Director

RT:dv:ms

cc: Ms. DeVerter

FINDING 1 Inadequate Separation of Duties

With limited employees within the Administrative Services Division, it is difficult for us to maintain adequate separation of duties; be able to provide backup when necessary and keep the work flow moving.

Purchasing/Fixed Assets

DBW feels this finding to be a minimal risk due to the internal review and approval process that that is currently in place for purchasing and the paying of invoices.

Cash Disbursements

DBW feels this finding to be a minimal risk. The Accountant Trainee does not originate the purchase orders that request revolving fund checks. All revolving fund checks are reviewed and signed by the Accounting Administrator or the Chief of Administration. The revolving fund reconciliation is submitted for review.

Receivables

DBW feels this finding to be a minimal risk. All billings, invoices, posting to the general ledger, reconciliations and collections are reviewed by the Accounting Administrator. In addition, the SCO reconciliation provides an additional avenue for reviewing these processes.

FINDING 2 Inadequate Controls over the Reconciliation Process

SCO Reconciliation

DBW feels this finding to be a minimal risk. This task has yet to be assigned to an appropriate staff level. It is therefore performed by the highest level in the Accounting Office. In addition, the year-end process ensures that reconciling items must be corrected in order to close the fiscal year.

Bank Reconciliation

DBW agrees with this finding. We are currently in the process of filling this vacancy and will implement the recommendation of insuring that the bank reconciliation will be properly signed and dated by the preparer and the reviewer.

Revolving Fund

The Department agrees with this finding. We are currently in the process of filling this vacancy and will implement the recommendation of insuring that revolving fund reconciliations will be properly signed and dated by the preparer and the reviewer.

Accounts Receivables

DBW disagrees with this finding. The reconciliation is performed monthly and retained according to retention schedules for accounting records. The reconciliations are reviewed by the Accounting Administrator and confirmed by the month-end process

FINDING 2 (Con't)

Fixed Assets (equipment)

DBW agrees with this finding. Corrective action will be taken to correct the general ledger balance. Completion date: December 1, 2006.

FINDING 3 UNTIMELY POSTINGS OF MAJOR REVISIONS TO THE ALLOTMENT EXPENDITURE LEDGER

DBW feels this finding to be a minimal risk. The Budget Revisions are posted the reports that is utilized by program managers and budget staff. Corrective action is being taken to post the Budget Revisions as described in SAMsection6533 and 8322.

FINDING 4 FAILURE TO PREPARE PRELISTINGS OR TRANSFER RECEIPTS

DBW finds this finding to be a minimal risk and consider it to be antiquated and not in the spirit of paper reduction.

FINDING 5 UNTIMELY REMITTANCE TO THE STATE TREASURER

DBW agrees with this finding. Cash receipts are deposited timely. Corrective action will be taken to insure that remittances to the State Treasurer are deposited within 30 following the date collected.

FINDING 6 INADEQUATE CONTROLS OVER SAFE ACCESS

DBW agrees with this finding feels this finding to be a minimal risk. Although we failed to maintain a record, adequate care and control has been placed over those individuals that have access to the safe and when the combination must be changed. Corrective action is being taken to ensure that a complete listing is being maintained.

FINDING 7 INADEQUATE COLLECTION EFFORTS ON DELINQUENT RECEIVABLES

DBW agrees with this finding. Written procedures to document this process will be completed by March 1, 2007.

FINDING 8 STOCK RECEIVED REPORTS ARE NOT COMPLETED TO RECORD RECEIPTS OF GOODS.

DBW finds this finding to be a minimal risk. When stock is received, it is entered into the DBW's procurement tracking system. When the invoice is being processed, the Accounting Office sends out a memo seeking verification to the receiver that that stock was actually received.

FINDING 9 FAILURE TO DESTROY OBSOLETE CHECKS

DBW agrees with this finding and had corrected this finding after the exit interview.

FINDING 10 LACK OF REVOLVING FUND CASH BOOK

DBW agrees with this finding. We are currently in the process of filling this vacancy and will implement the recommendation of ensuring that a revolving fund cash book is maintained and reconciled to the revolving fund advance on a regular basis.

FINDING 11 LACK OF PETTY CASH CUSTODIANSHIP AND RECORDS

DBW feels this finding to be a minimal risk. DBW has not used this process for a number of years and it will be eliminated.

FINDING 12 LACK OF INDEPENDENT REVIEW OF SEPARATED EMPLOYEE PAYMENTS

DBW agrees with this finding. Corrective action will be taken to include a review by another staff member for lump-sum payment calculations.

FINDING 13 INCOMPLETE PROPERTY LEDGER

DBW agrees with this finding. Corrective action will be taken to ensure that the property ledger is reliable. Complete date: December 1, 2006.

FINDING 14 INADEQUATE INVENTORY PROCEDURES

DBW agrees with this finding. Corrective action will be taken to include inventory counts and that inventory sheets are signed and dated by the employee who verified the location and existence of the state equipment.

FINDING 15 DEPRECIATION OF FIXED ASSETS NOT PERFORMED

DBW agrees with this finding. Corrective action will be taken to ensure fixed assets are depreciated in accordance with SAM and Generally Accepted Accounting Principles. Completion date: December 1, 2006.

FINDING 16 UNTIMELY SUBMISSION OF FEDERAL REPORTS

DBW agrees with this finding. Corrective action will be taken to ensure that required federal reports are submitted on time.

EVALUATION OF RESPONSE

The Department of Finance, Office of State Audits and Evaluations (Finance) reviewed the Department of Boating and Waterways' (Department) response to our review of their internal control in effect as of December 8, 2005. The Department's response is included in this report. We acknowledge the Department's willingness to implement corrective actions for most of the findings identified in the draft report, and believe the implementation of the corrective actions identified will strengthen the Department's internal control and reduce the risk of errors or irregularities in the financial statements, and loss of state assets from unauthorized use and disposition.

The following comments are to the findings that the Department disagreed or did not adequately address in the response:

FINDING 1 Inadequate Separation of Duties

The Department asserts that staffing issues prevent implementation of separation of duties over key functional areas in purchasing, asset security, and accounting. The Department further responded that these areas are minimal risk since offsetting control procedures exist. However, effective internal control requires a commitment from management and the Department assumes responsibility for any potential losses associated with its current practices. If implemented, our recommendation would reduce risks in the areas of purchasing, fixed assets, disbursements, and receivables. Therefore, we maintain our recommendation that duties need to be additionally segregated to ensure adequate safeguarding of state assets.

FINDING 2 Inadequate Controls over the Reconciliation Process

SCO Reconciliations

The Department's response does not adequately address the finding. The State Administrative Manual (SAM) section 7908 requires that all reconciliations show the preparer and reviewer's name and include the date the reconciliation was performed and reviewed. Therefore, the finding remains as originally reported.

Accounts Receivable

The Department does not concur with this finding. The Department asserts that it performs the monthly account receivable reconciliation. However, as stated in the report, Finance was unable to verify the performance of this procedure since the Department did not retain the reconciliation records at the time of the review. Therefore, the finding remains as originally reported.

FINDING 4 Failure to Prepare Prelistings or Transfer Receipts

The Department does not concur with this finding, indicating that the loss of checks is low risk. It further states that prelisting of checks and transfer receipts are antiquated control procedures. Finance disagrees. Negotiable instruments, such as checks, are high risk state assets prone to loss due to theft. To protect the state's interest, SAM section 8021 requires the Department to prepare a prelist of checks received and a transfer receipt of checks distributed between employees. Therefore, the finding remains as originally reported.

FINDING 8 Stock Received reports Are Not Completed to Record Receipt of Goods

The Department indicated that the use of stock received reports to substantiate receipt of goods is a low risk procedure, and their alternative procedures strengthen their procurement practices. However, SAM Section 8422.20 requires state departments to prepare Stock Received Reports, STD. 106, or other approved purchase order documents to substantiate receipt of goods prior to payment for those goods. Therefore, the finding remains as originally reported.